



State Investment Commission
Monthly Meeting Minutes
Wednesday, May 25, 2016
9:00 a.m.
Room 205, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:05 a.m., Wednesday, May 25, 2016 in Room 205, State House.

I. Roll Call of Members

The following members were present: Mr. Robert Benson, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Frank Karpinski, Ms. Marie Langlois, Ms. Faith LaSalle, Ms. Marcia Reback, and Treasurer Seth Magaziner.

Also in attendance: Ms. Tiffany Spudich of Capital Cities LLC, 529 plan consultant; Mr. Joseph Newton of Gabriel Roeder, actuary; Mr. John Burns of Pension Consulting Alliance (PCA), general consultant; Ms. Sally Dowling of Adler Pollock & Sheehan P.C., legal counsel; Ms. Anne-Marie Fink, Chief Investment Officer; Mr. Patrick Marr, Deputy Treasurer/Chief Operating Officer; Ms. Kimberly Shockley, Associate Director of the College & Retirement Savings Plans and members of the Treasurer's Office staff. Treasurer Magaziner called the meeting to order at 9:05 a.m.

II. Approval of Minutes

On a motion by Ms. Reback and seconded by Ms. Langlois, it was unanimously

VOTED: to approve the draft of the minutes of the April 27, 2016 meeting of the State Investment Commission.

III. Recommendation on Defined Contribution Plan Target Retirement Funds

Ms. Shockley requested approval to transfer the current life-cycle funds from Vanguard Target Retirement Trust II to Vanguard Target Retirement Trust I. The move would reduce the current net expense ratio on these funds from 8 basis points (0.08%) to 7 basis points (0.07%) and, based on current balances, would save members over \$43,000 a year and an additional \$10,000 each subsequent year at the current contribution rate. Transferring to Trust I, at the current expense ratio, would mean the state has cut fee rates in the life-cycle funds by more than 50% since inception.

On a motion by Ms. Reback and seconded by Mr. Fay, it was unanimously

VOTED: to approve the transfer from Vanguard Target Retirement Trust II to Vanguard Target Retirement Trust I

IV. CollegeBoundfund Semi-Annual Performance Review

Ms. Spudich presented the Semi-Annual Performance Review of the 529 Plan on behalf of Capital Cities, the 529 investment consultant. She began with a brief market overview, and then explained how those conditions impacted CollegeBoundfund's performance, focusing mostly on the Education Strategies aged-based portfolios and the fixed allocation portfolios, as these multi-asset portfolios hold the majority of the program's assets. The portfolios' performance for the quarter ranged from -1.3% to +0.9%. Generally over this period the funds that were more conservative and had more exposure to bonds fared better than those

exposed to equities and real return strategies. The AB mid-cap growth strategy and AB multi-asset real return fund were the main detractors from performance in the Education Strategies; therefore, Capital Cities further reviewed these funds. Ms. Spudich said they found that the AB midcap growth trailed the benchmark by two percentage points due to their emphasis on the fastest growing companies, which underperformed in the first quarter. While the AB multi-asset real return fund had a 2.3% return, it trailed its benchmark by more than six percentage points due to its diversified approach relative to the benchmark that concentrates in commodities.

The board asked questions.

V. Recommendation on 529 Investment Policy Statement (IPS)

Ms. Spudich introduced a new IPS that Capital Cities drafted for the upcoming program manager transition. She highlighted the proposed changes. Firstly, she noted there will be changes in program names. The program has been called the “CollegeBound*fund*” with the advisor-sold program called the “CollegeBound*fund* national accounts” and for the direct program the “CollegeBound*fund* Rhode Island account”. Starting with the transition to the new program managers CollegeBound Saver will be used for the direct plan and CollegeBound 529 for the advisor plan.

Next Ms. Spudich pointed out that the Rhode Island Higher Education Assistance Authority (RIHEAA) and their responsibilities have been removed from the document and Ascensus has been added as the new program manager, responsible for day-to-day operations, regulatory reporting and marketing. The new IPS also described Invesco’s responsibilities, which are asset allocation investment services, marketing and distribution. Bank of New York Mellon has been added as the new custodian of program and program disclosures have been simplified.

Ms. Spudich pointed out that the aged-based portfolios are being maintained. She commented that the program will continue to transition portfolios from one age band to another gradually over several quarters, whereas other 529 plans make shifts only on a yearly basis. CollegeBound’s approach gives participants the “smoothest ride” and minimizes timing risk around age-band transitions. She also noted that Ascensus is planning to rebalance on monthly basis if any portfolio falls outside of the 1 percentage point threshold for target asset class weighting. She also reminded the board that the target-risk portfolios and individual portfolios will have static allocations and will not transition over time.

Ms. Spudich called attention to the fact that many details of the plan have specifically been added to the Appendix of the IPS document so that any changes could be made to the Appendix without having to rework the entire IPS.

Ms. Langlois asked if the name changes were necessary given the change in program management. Ms. Spudich indicated that while they were not necessary, both Ascensus and Invesco did customer surveys regarding the appeal of the names and based the new names on the options that were most popular with participants.

On a motion by Ms. Reback and seconded by Ms. LaSalle, it was unanimously

VOTED: to approve changes to the 529 Investment Policy Statement

VI. Recommendation on CollegeBoundfund Auditor

Mr. Patrick Marr discussed retaining Marcum LLP for the FY 2016 audit of the CollegeBoundfund. Due to the transition of program oversight from RIHEAA to Treasury, as well as the upcoming transition from AB Global (Alliance Bernstein) to Ascensus, it seemed advisable to use the same auditor as the prior two years. Mr. Marr related his discussion with the Office of Accounts & Control and the Office of the Auditor General who also found it prudent to retain Marcum LLP. Mr. Marr explained that maintaining this auditor would ensure the audits are prepared consistently with those from the recent past, utilizing the same. Under the direction of the Auditor General, Treasury has engaged in negotiations to employ Marcum LLP to oversee the execution of the transition agreement, which would be a tri-party agreement among AB Global, the Treasurer's office and Ascensus. Mr. Marr requested approval to enter into a contract with Marcum to this effect not to exceed \$30,000. Mr. Marr pointed out that both the Office of the Auditor General and the Controller's office have given their support for keeping Marcum LLC through the FY16 audit.

Mr. Fay asked for clarification if the contract with Marcum LLP would be renewed or if it would be a new contract. Mr. Marr answered that there would be a new agreement under a different engagement letter for the term of one year and reiterated that Marcum was obtained by competitive bid for a 2-year term in 2014. The purpose of this recommendation would permit the state to retain them for an additional year to complete the FY16 audit as well as the audit of the transition. He confirmed that Treasury is planning to conduct a competitive bidding process for the 529 Plan's FY17 audit.

On a motion by Mr. Benson and seconded by Mr. Fay, it was unanimously

VOTED: to approve retaining the current CollegeBoundfund auditor, Marcum LLP

VII. Briefing: Community Deposit Program

Mr. Marr introduced the proposed Community Deposit Program, which is a major addition to the short-term investment policy. The program is designed based on successful policies in multiple states. The program is a way to use the State's bank deposits to encourage banks to lend to small businesses and first-time entrepreneurs in Rhode Island. He described how the program would work: Treasury would deposit some of the State's short-term cash with banks that made qualifying loans to local businesses. Mr. Marr emphasized that banks participating in the program would be subject to the same SIC criteria in terms of quality, security and stability. The program would support loans up to \$250,000 for a term of up to 5 years. The deposits would likely be comprised of certificates of deposits. The terms of the program make explicit that the SIC and Treasurer preserve security and liquidity above all else, and no investments would have a term of more than 1-year, consistent with the short-term policy.

Mr. Marr explained the cash accounts best suited to fund the program. He indicated there is cash in the TDI reserve fund that is very stable and would be ideal for this type of investment, as well as other similar funds that also have sticky cash. The TDI reserve fund currently holds \$89 million and the Community Deposit Program will be capped at \$30 million, which is between 5-10% of cash held in all state accounts, a level consistent with that of other states with similar programs.

The board asked questions.

VIII. Recommendation on Short-Term Investment Policy Changes

Next Mr. Marr discussed the recommended changes to the existing Short-Term Investment Policy (STIP) document. These changes included incorporating the Community Deposit Program as well as correcting typographical errors and generally updating the document to align with what is used. The recommended

revised STIP also reflects a change in maturity dates from one year to 397 days to harmonize the policy with the Security and Exchange Commission's rule 2-A7 that regulates money market and other short-term funds. Additionally the revised STIP updates the collateralization definition for better clarity and to better reflect common practices and procedures.

On a motion by Ms. Reback and seconded by Mr. Fay, it was unanimously
VOTED: to approve changes to the Short-Term Investment Policy

IX. Recommendation on Community Deposit Program

On a motion by Ms. Reback and seconded by Mr. Fay, it was unanimously
VOTED: to approve the adoption of the Community Deposit Program

X. Briefing : Pension Liabilities

Treasurer Magaziner stated this discussion was to be a primer for the summer's upcoming asset/liability study and introduced Joe Newton of Gabriel Roeder. Mr. Newton talked about the pension liability and how it fits with the asset side of the pension system. He was clear to note that there is no absolute truth or objective answer when it comes to looking at risk tolerance. He explained the relationship between risk tolerance and cost tolerance, explaining that people tend to have zero risk tolerance until shown the cost; cost tolerance has an inverse relationship to risk tolerance. He explained how this trade-off can frame discussions when managing asset allocations to meet specific liabilities.

Mr. Newton mentioned that size, type of funds, contributions, ratio of actives to retirees, funded ratios and other key characteristics of a plan will have a significant impact when determining risk tolerance for the investment portfolio. Because these characteristics vary widely among pension systems, Mr. Newton felt portfolios cannot necessarily be compared to other plans. He stated that each plan has their own set of objectives within their own set of criteria. He warned that just because peers are engaging in certain funds and behavior does not mean similar approaches would be beneficial for others; each fund is different in terms of size, pools, investments, etc.

Mr. Newton pointed out that both the SIC and the Retirement Board were anticipating decisions about the entire plan. The SIC would be addressing the portfolio's asset allocation prior to the Retirement Board's experience study, which examines the liabilities as well as setting the plan's target rate of return. He suggested the outcome of the SIC's asset allocation work would be influential on the Retirement Board's return target. Overall he recommended that the discussions take place in conjunction with each other and the two boards formulate strategic decisions together.

Mr. Newton then spent significant time explaining the drivers of his liability calculations, walking through several scenarios and sensitivities. He concluded that there is always a trade-off between investment risk and the cost of the plan.

The board asked questions.

XI. Recommendation on Commissioning Asset/Liability Study

Mr. Burns gave a presentation that outlined the asset/liability study process and provided some background on how it works. He described a series of intensive meetings at which the members would become properly

educated on a variety of issues and have thorough discussions about risk tolerance and risk management. A large part of the process is for members to outline the financial risks they want to manage against and then determine their tolerance for those risks. These initial discussions will be expected to flesh out the issues most important to address in the portfolio. Once the baseline for risks is established, a discussion will proceed about how to manage those risks.

Mr. Burns explained the study will assess the fund's current and predicted financial condition and how the plan's health might vary under different asset portfolios. Subsequently, the PCA will use its asset allocation quantitative model to recommend a portfolio that addresses these findings.

Mr. Burns said that the PCA model will customize for how the Rhode Island liabilities are structured. He also explained the asset/liability study would also explore what other institutional investors are currently doing, analyzing their strategies and philosophies, as well as their overall financial health and any approaches that might be beneficial for Rhode Island to implement going forward.

The board asked questions.

On a motion by Mr. Benson and seconded by Mr. Fay, it was unanimously
VOTED: to approve the commission of an Asset /Liability Study

XII. Legal Counsel Report

There was no legal counsel report.

XIII. Chief Investment Officer Report

Ms. Fink reviewed the performance of the portfolio for April. She stated that April was a good month for the market, as well as the fund. The fund was up 1.3%, beating both the bottom-up benchmark and the basic 60% equity/40% bonds allocation. She described April as an interesting month, the polar opposite of January, with commodities up substantially and MLPs were up 12%. Corporate loans and credit were also huge performers as markets became more positive on global growth. The portfolio's more aggressive asset manager, Western Asset Management was up 2.7% and Brigade, the long/short- credit hedge fund was up 4.7%. International equity was up 2.6%.

On the detracting side, private equity was down 0.66%, as performance reflected the market softness from the first quarter. Hedge funds did better than in March and she described the positive trend as continuing in May based on mid-month numbers. She reminded that the portfolio's hedge funds have low beta, so did not keep up with the global stock market in the strong April rally.

The QVM (quality, value, momentum) factor tilt portfolio had a tough month giving back some of the strong performance in the portfolio's first six months. Quality and momentum underperformed for the month but May was looking better based on input from the portfolio's manager State Street.

Looking longer term, Ms. Fink explained the overall portfolio is up 2.1% on the calendar year and down less than 1% for the fiscal year to date, which is a notable improvement from the start of the year. The portfolio has underperformed the 60/40 in both the calendar and fiscal year to date; however, in the 3- and 5-year periods, it is outperforming in risk-adjusted returns.

Ms. Fink also spoke to the voluminous public records request the office received in March, which was completed on May 9th when the office delivered over 9000 pages to the requestor. It took roughly 480 employee work hours to complete the request.

Going forward through the month of June, Ms. Fink noted the main focus of the office will be on the 529 transition, which takes place on July 8th. There is a significant amount of documents and communications to be finalized before that time.

The board asked questions.

XIV. Treasurer's General Comments

Treasurer Magaziner indicated that the commissioning of the asset/liability study meant that the SIC would need additional meetings throughout the summer to discuss related issues. The office will be working on a proposed schedule to accommodate the supplemental meetings.

The Treasurer thanked Faith LaSalle for her service, as it was her last meeting on the board. He expressed it had been terrific working with her. He recognized her being especially helpful in the CollegeBound*fund* manager selection.

He also introduced Sylvia Maxfield (in absentia), the Dean of Providence College's Business School, as the new SIC member who will begin serving in June.

There being no other business to come before the Board, on a motion by Ms. Reback and seconded by Mr. Fay the meeting adjourned at 11:09 a.m.

Respectfully submitted,

**Seth Magaziner,
General Treasurer**